STATE OF NEW JERSEY
Board of Public Utilities
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ENERGY

IN THE MATTER OF ATLANTIC CITY ELECTRIC COMPANY'S PRIVATE LETTER RULING REQUEST SEEKING A FINDING THAT THE CONTINUED FLOW-THROUGH TO RATEPAYERS OF UNAMORTIZED INVESTMENT TAX CREDITS, EXCESS DEFERRED INCOME TAXES, AND ACCUMULATED DEFERRED INCOME TAXES ASSOCIATED WITH CERTAIN DIVESTED GENERATING ASSETS WOULD NOT VIOLATE THE IRS' NORMALIZATION RULES[1])

ORDER DENYING MOTION FOR STAY

DOCKET NO. EO06040315

(SERVICE LIST ATTACHED)

BY THE BOARD:

Before the Board of Public Utilities ("Board" or "BPU") is a motion by Atlantic City Electric Company ("ACE" or "Company") for reconsideration[2] or stay of the May 5, 2006 Order in the within matter by which the Board directed ACE to withdraw its request to the Internal Revenue Service ("IRS") for a Private Letter Ruling ("PLR") regarding the disposition of accumulated deferred investment tax credit ("ADITC"), excess deferred income taxes ("EDIT" or "EDFIT"), and accumulated deferred income taxes ("ADIT" or "ADFIT") balances associated with divested nuclear generation assets unless ACE requests and the IRS agrees not to issue a PLR until

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[1] The caption of this matter has been revised so as to more accurately reflect the tax benefits at issue in the Private Letter Ruling request.

[2] Because ACE has filed an appeal of the Board's May 5, 2006 Order with the Superior Court of New Jersey, Appellate Division, the Board, absent a remand, does not have jurisdiction to reconsider its Order. See R. 2:9-1(a). Pursuant to R. 2:9-7, the Board does have jurisdiction to consider an application for a stay of its Order pending an appeal. The Board has considered ACE's arguments on reconsideration to the extent that they relate to the likelihood of ACE succeeding on the merits of its appeal, which, as discussed infra, is a factor considered with regard to a stay application. As discussed more fully below, the Board does not find a likelihood of success on the merits of its appeal and therefore, does not find it necessary to seek a remand to further consider the motion for reconsideration.

after there has been a final resolution of an IRS rulemaking addressing these issues. At the Board's May 22, 2006 special agenda meeting, ACE and the Division of the Ratepayer Advocate ("RPA"), which opposes the motion, were afforded the opportunity to present oral argument. The Board has carefully considered ACE's written submission, and the oral argument by ACE and the RPA.

BACKGROUND

Following the enactment of the Electric Discount and Energy Competition Act, N.J.S.A. 48:3-49 et seq., as part of its July 21, 2000 Decision and Order in I/M/O the Petition of Atlantic City Electric Company Regarding the Sale of Nuclear Assets, Docket No. EM99110870 ("2000 Order"), the Board approved the sale of ACE's minority interests in the Salem Nuclear Generating Station, Units 1 and 2, Peach Bottom Atomic Power Station, Units 2 and 3, and the Hope Creek Nuclear Generating Station, as well as the recovery of stranded costs. In its 2000 Order, the Board did not resolve, and specifically held open, the disposition of the accumulated deferred investment tax credit, excess deferred income tax, and accumulated deferred income tax balances associated with the nuclear generation assets to be divested. The BPU's 2000 Order, consistent with the Board's prior Orders relating to other utilities' divestitures of generation assets, held this issue open and directed ACE to seek a private letter ruling from the Internal Revenue Service to determine whether or not the value of the various tax benefits could continue to be flowed through to ratepayers without violating the tax normalization policies of that agency. 2000 Order at 22. The Board noted that its "final determination of the net proceeds and stranded costs (the post-closing true-up proposed by the Company on page 26 of the petition) shall await the outcome of this ruling." 2000 Order at 22-23.

IRS Revenue Procedure 2001-1, Section 9.01 (now 2006-1, Appendix E), provided that a letter ruling request that involves a question of whether a rate order that is proposed or issued by a regulatory agency will meet certain normalization requirements ordinarily will not be considered unless the taxpayer states in the letter ruling request whether the regulatory authority responsible for establishing or approving the taxpayer's rates has reviewed the request and believes that the request is adequate and complete, and the taxpayer will permit the regulatory authority to participate in any IRS Associate office conference concerning the request. By letter dated December 11, 2002, the Board's Secretary informed ACE that the Board reviewed a draft letter ruling request submitted to it by ACE and found the draft to be accurate and complete and confirmed that ACE committed to permit the Board's participation in any national office conference concerning the request.

By letter dated December 12, 2002, Pepco Holdings, Inc. ("PHI"), on behalf of its indirect wholly-owned subsidiary, ACE, requested the IRS to rule that the Company would not violate IRS normalization requirements if its stranded costs for the nuclear facilities were reduced by the ADITC, EDIT, and ADFIT associated with these assets, thereby flowing these benefits through to ratepayers. ACE argued that interpretations of normalization rules in prior private letter rulings, which concluded that when property ceased to be public utility property the tax benefits could not be flowed through to ratepayers, were intended to apply to a regulated electric generating industry, and that deregulation of the industry necessitates a new approach to normalization. ACE argued in its PLR request, at 26-27:

> Generally, assets that are no longer public utility property and are not included in rate base would no longer be the economic responsibility of the ratepayers. The BPU's approval of stranded

costs and the imposition of the TBC [transition bond charge] on ratepayers require the ratepayers to economically support generation assets that are no longer in regulatory service. It would seem appropriate to the extent the ratepayers are supporting those assets that they should also receive the benefits associated with those assets. Perhaps, one way to view the imposition of the TBC is that the ratepayers, at least as to the stranded cost portion, are the "purchasers" of the assets and as such should be entitled to any benefits of ownership, including the ADFIT, EDFIT and ADITC. Furthermore, providing for the pass through of these benefits would not thwart legislative purpose behind the normalization rules. The stranded cost represents an asset that has already been economically depreciated and any tax benefits associated with that economic depreciation should be for the benefit of the party bearing that burden.

No final PLR has been issued by the IRS on this request to date. Post-divestiture, ratepayers are paying $675 million over the 20-year life of the transition bonds issued by ACE to recover the stranded cost of its nuclear units, or approximately $34 million annually. Moreover, ratepayers will pay approximately $150 million in federal income taxes associated with the recovery of the principal of the transition bonds issued for the recovery of these stranded costs

By notice published at 68 Fed. Reg. 10190 (March 4, 2003), encaptioned "Application of Normalization Accounting Rules to Balances of Excess Deferred Income Taxes and Accumulated Deferred Investment Tax Credits of Public Utilities Whose Generation Assets Cease To Be Public Utility Property," the IRS discussed ADFIT, EDIT and ADITC. Recognizing that the electric industry was undergoing substantial changes, that utilities were selling generation assets to new entities that are not subject to rate of return regulation, and that the IRS had issued private letter rulings holding that the flow-through of EDFIT and ADITC reserves associated with an asset is not permitted after the asset's deregulation, the IRS, after further consideration, proposed regulations providing for the flow-through of EDFIT and ADITC, concluding that neither former section 46(f) nor section 203(e) of the Tax Reform Act suggest that EDFIT and ADITC reserves should not ultimately be flowed through to ratepayers and that such flow-through therefore could occur without violating normalization rules. The regulations were proposed to apply to property deregulated after March 4, 2003, and utilities could elect to apply the proposed rules to property that became deregulated generation property prior thereto. The Board filed comments in support of the proposed regulations.

On December 21, 2005, the Board initiated a generic proceeding (BPU Docket Nos. EX02060363, EX02060364, EX02060365, EX02060366) in order to formulate an appropriate regulatory treatment for ITC related to generation assets. Comments were solicited and received from the State's electric distribution companies and the RPA.

Also on December 21, 2005, by notice published at 70 Fed. Reg. 75762 (December 21, 2005), encaptioned "Application of Normalization Accounting Rules to Balances of Excess Deferred Income Taxes and Accumulated Deferred Investment Tax Credits of Public Utilities Whose Assets Cease to Be Public Utility Property," with corrections published at 70 Fed. Reg. 76433 (December 27, 2005), the IRS withdrew its March 4, 2003 proposed rulemaking, again discussed ADFIT, EDFIT and ADITC, and proposed new regulations. The IRS again recognized that it had issued private letter rulings holding that the flow-through of EDFIT and ADITC reserves associated with an asset is not permitted after the asset's deregulation, and again concluded, after further consideration, that the flow-through of EDFIT and ADITC would not violate normalization requirements provided certain criteria are met. It proposed to permit such flow-through, but limited it, however, to plant that ceased to be public utility property after December 21, 2005, with certain exceptions for plant that ceased to be public utility property on or after March 5, 2003. The Board has commented on the proposed regulations and urged the IRS to make certain modifications thereto, including, among other things, elimination of the arbitrary time constraints for allowing the flow-through to ratepayers of unamortized investment tax credits and excess deferred income taxes associated with divested utility plant.

In April 2006, the IRS informed ACE that it had reached a tentative decision adverse to the PLR requested by ACE. On April 17, 2006, at ACE's request, and pursuant to IRS procedures, a Conference of Right was held by telephone with the IRS and ACE, along with representatives of the Board and the RPA. The IRS indicated that comments could be submitted within 21 days, through ACE.

MAY 5, 2006 ORDER

By telephone conference call on April 20, 2006, confirmed by letter dated April 21, 2006, the Board's Staff provided notice to the affected utilities and the RPA that this matter would be considered by the Board at its April 26, 2006 agenda meeting, and that the Board's Staff anticipated that it may recommend to the Board that, in light of the subsequent events described above, it reconsider prior directives to ACE, as well as directives to Public Service Electric and Gas Company ("PSE&G") and Jersey Central Power and Light Company ("JCP&L"), to seek private letter rulings from the IRS. The notice further indicated that Staff may recommend that the Board revoke its aforementioned prior directives to seek PLRs and direct the utilities to withdraw their requests for PLRs from the IRS immediately, with the flow-through issue continuing to be considered by the IRS in the context of its rulemaking, subject to judicial review. An opportunity for each utility and the RPA to submit comments on whether these actions should be taken by the Board was provided.

By letter dated April 24, 2006, from Roger Pedersen, Manager New Jersey Regulatory Affairs for ACE ("ACE letter"), ACE objected to the potential Board action. ACE argued that a withdrawal of the ruling request would be a "de facto adverse private letter ruling" as the IRS would notify the appropriate local offices and would likely instruct them to challenge any return position inconsistent with the IRS' position on the Stranded Cost Reduction issue. ACE further argued that if the BPU believes the IRS' proposed regulations, once final, are incorrect, an issued ruling will not impede or change any of the BPU's options or otherwise impair any legal challenges. According to ACE, an issued ruling would, however, provide guidance to ACE and the BPU on how to proceed in the event the BPU decides not to pursue the issue or in the event the BPU is unsuccessful in its efforts to challenge the regulation. ACE also noted that the treatment of ADFIT received no further guidance in the IRS' proposed regulations beyond what is already available and the issue would likely not be any clearer in the final regulations. Therefore, ACE maintained that a PLR would provide certainty with respect to this issue and appeared to be the only way ACE can meet its requirements under the current Order. ACE further argued that there is also no assurance that the Service would rule again on the Stranded Cost Reduction issue, and to proceed without this guidance would be a mistake and could lead to making an incorrect assumption that will have undesirable repercussions for New Jersey customers. ACE also indicated that as an option, ACE would consider requesting that the IRS hold off on ruling adversely until the proposed regulations become final. This, it recognized, would give the BPU additional time to address its concerns with the IRS.

ACE also asserted that there are no administrative procedures available to appeal final regulations other than convincing the IRS to withdraw them. The only challenge would have to be done judicially and, in order to do so, the BPU would have to first cause a violation of the final regulations, and that this would cause a normalization violation with severe consequences. The Company asserted that a normalization violation would require ACE to repay the ADITC for both the divested assets and retained assets, including the unamortized ADITC related to the transmission and distribution assets. ACE claimed that such consequences would increase ACE's cost of service to account for additional interest costs (for borrowings required to repay the money to the IRS), as well as an increase in ACE's income tax expense, as there will be no ADITC left to amortize. In addition, ACE posited that it would be disallowed accelerated depreciation with respect to assets in service at the time of the normalization violation, likely on a permanent basis. The Company requested that the BPU carefully consider its course of action, because "any challenge to the final regulations will have severe and immediate consequences to ACE and its customers." ACE letter, at 6.

By letter dated April 24, 2006 from the RPA by Diane Schulze, Assistant Deputy Ratepayer Advocate ("RPA letter"), the RPA requested that the Board order ACE, as well as PSE&G and JCP&L, to immediately withdraw their PLR requests addressing the ITC issue due to the proposed IRS regulation on the issue. The RPA maintained that with the delay in the IRS responding to the PLR requests, circumstances have changed to make the rulings no longer necessary. The RPA asserted that the "letter rulings are no longer necessary and may even be detrimental to obtaining clarification on the issue." RPA letter, at 7.

After considering the written submissions of ACE and the RPA, the Board rendered an Order dated May 5, 2006. The Board noted that the IRS has clearly recognized that the flow-through issues are appropriate for rulemaking by publishing two notices of proposed regulations, in 2003 and 2005. While the IRS had indicated that, before its 2003 proposed rulemaking, it had issued PLRs holding that flow-through of the EDFIT and ADITC reserves associated with an asset is not permitted after the asset's deregulation, based on the principle that flow-through is permitted only over the asset's regulatory life and when that life is terminated by deregulation no further flow-through is permitted, the rulemaking indicates that after further consideration the IRS and the Department of Treasury have concluded that the relevant statutory provisions do <u>not</u> prohibit a utility from flowing through ADITC reserves after deregulation and EDFIT reserves with respect to deregulated utility property. 2005 Rulemaking, at 75763. Accordingly, based on the IRS' interpretation of the relevant statutes and their underlying policy and intent, the proposed regulations would permit flow-through of the ADITC reserve with respect to public utility property to continue after its deregulation to the extent the reduction in cost of service does not exceed, as a percentage of the ADITC with respect to the property at the time of deregulation, the percentage of the total stranded cost that the taxpayer is permitted to recover with respect to the property. In addition, the credit may not be flowed through more rapidly than the rate at which the taxpayer is permitted to recover the stranded cost with respect to the property. It also would permit the flow-through of EDFIT. Although the 2003 proposed regulations would have permitted utilities to elect to apply the proposed rules to property that was deregulated on or before March 4, 2003, the 2005 Rulemaking proposed other provisions pertaining to the regulations' effective date:

> Comments suggested that deregulation agreements between utilities and their regulators entered into before the March 4, 2003 proposed effective date were based on the only guidance then available (*i.e.*, the private letter rulings issued by the IRS) and that the availability of a retroactive election could effectively change the terms of those agreements. Although private letter rulings are

directed only to the taxpayers who requested them and may not be used or cited as precedent, the IRS and Treasury have concluded that the Secretary's authority under section 7805(b)(7) to provide for retroactive elections should not be exercised in a manner that impairs existing agreements between utilities and their regulators.

[2005 Rulemaking, at 75763 (emphasis supplied)

As the Board explained in its comments to the IRS on the proposed regulations, this proposed rationale for eliminating retroactivity does not apply to the situation in New Jersey. Although New Jersey's electric industry completed its deregulation prior to March 2003, the Board specifically carved out the issue of proper treatment of ADITC and EDFIT in its restructuring orders, including the ACE restructuring order. The Board's 2000 Order did not depend at all on any private letter rulings that preceded it, and left this issue open with a directive to ACE to seek a letter ruling from the IRS to determine whether or not the value of the tax benefits can legitimately be credited to customers without violating the tax normalization policies of that Agency to the detriment of the Company and the customers. Accordingly, flow-through could be allowed without making any change in the terms of the Board's 2000 Order and without making any change in the basis for that Order contemplated by the parties at the time it was issued, and without impairing any existing agreements between utilities and their regulators. The reasoning underlying the 2005 Rulemaking's effective date, therefore, is inapplicable to ACE's request and should be modified, as the Board submitted in its rulemaking comments to the IRS.

The Board further discussed that notwithstanding its own proposal of rules in March 2003 to interpret the relevant statutory provisions, and its own proposal of rules again in December 2005, and its having afforded opportunities for interested parties to provide comments on the proposals for the IRS' consideration, the IRS apparently now seeks to issue interpretations through a series of private letter rulings addressing ACE, two other New Jersey utilities, PSE&G and JCP&L, and possibly a number of other utilities as well. The Board further noted that while the IRS has indicated that the Board and the RPA may submit comments on this issue through the taxpayer utility, the IRS has asserted further that no such third party would have standing to contest a private letter ruling through judicial review. The Board concluded that the IRS should not take action of such broad scope and applicability, with such a large financial impact on millions of ratepayers, through a piecemeal process that eliminates any real scrutiny on behalf of the many people affected by the action. The Board expressed its strong view that the IRS should, as it is in the process of doing, resolve the outstanding questions by considering the comments of the Board and other interested parties and finalizing its proposed rulemaking, subject to such judicial review as may be appropriate. The Board also stated that were the IRS to issue a PLR without first completing its pending rulemaking, including that part of the rulemaking pertaining to the effective date for the IRS' statutory interpretations, it would vitiate the opportunity to be heard that was to be provided to the Board and other interested parties in the rulemaking, and would prematurely judge issues prior to their full and due consideration by the IRS pursuant to its own notice of rulemaking. As to ACE's contention that the finalized regulation would supersede any previously issued PLR, the Board found that that is not certain at this juncture, and, in fact, the IRS' current proposal provides that as to public utility property deregulated on or before December 21, 2005, the IRS will follow holdings set forth in previously issued PLRs.

The Board also found that ACE has not provided any support for its assertion that any challenge to the final regulations will have "severe and immediate consequences" to ACE and its customers and noted that the Board is not proposing that ACE violate any federal regulations, or cause a normalization violation. Rather, the Board, in recognition of the changed circumstances since its 2000 Order, and after careful consideration and balancing of the interests and concerns of ACE, which, in its request for a PLR, supported and argued for the flow-through to ratepayers, and the interests of its ratepayers, who, prior to divestiture, funded ACE's assets through depreciation charges and who, post-divestiture, continue to fund stranded costs of the generation assets, the Board set forth its belief that the flow-through issues should be considered in the pending rulemaking and the IRS, therefore, should not issue a private letter ruling to ACE to address these same issues prior to the final resolution of the pending rulemaking. The Board emphasized that proceeding in this manner is consistent with Internal Revenue Procedures which provide that letter rulings are given when appropriate in the interest of sound tax administration, and that the IRS "will not issue a letter ruling if the request presents an issue that cannot be readily resolved before a regulation or any other published guidance is issued." Rev. Proc. 2006-6.09. While the Board concurred with ACE as to the need for the IRS' guidance as to the tax consequences of a flow-through to ratepayers, given the IRS' own rulemakings proposing different provisions as to effective dates of the IRS' statutory interpretations, the Board found that the request at issue cannot be readily resolved before the rulemaking concludes. IRS procedures also provide that a taxpayer may withdraw a request for a letter ruling at any time before the letter ruling is signed by the IRS, Rev. Proc. 2006-7.07, and the Board found that in the within context, unless the IRS will grant a request to hold the PLR request in abeyance pending the rulemaking, ACE should withdraw its PLR request.

Accordingly, pursuant to N.J.S.A. 48:2-40, and in light of the subsequent events that have occurred since the issuance of the 2000 Order, the Board, by its May 5, 2006 Order, modified its prior directive to ACE to seek a PLR, and directed ACE to deliver to the IRS, by 5:00 p.m. on May 8, 2006, a withdrawal of its request for a PLR. The Board indicated that ACE may state in its withdrawal that if the IRS agrees not to issue a PLR until after there has been a final resolution of an IRS rulemaking that addresses the tax implications of a flow- through to ratepayers, including any appeals from the rulemaking, then ACE's request for a PLR shall be deemed not to be withdrawn. ACE was further ordered to simultaneously file with the Board's Secretary a copy of its withdrawal of the PLR, stating the date and time on which the withdrawal was delivered to the IRS. The Board emphasized that its determination on flow-through to ratepayers continues to remain open pending the resolution of the issue through IRS rulemaking, and that the Board is not directing a flow-through at this time. Additionally, the Board further directed ACE to deliver to the IRS, by 5:00 p.m. on May 8, 2006, comments to be received from the BPU which would urge that the PLR request be held in abeyance, as well as comments by the RPA with respect to the proposed PLR.

MOTION FOR RECONSIDERATION OR STAY

By letter dated May 5, 2006, ACE advised the Board's Secretary that it had requested and the IRS had granted an extension of the comment period until noon on May 11, 2006. ACE requested an extension for compliance with the May 5, 2006 Order until noon on May 11, 2006. By letter dated May 9, 2006, the Board's Secretary informed ACE that, based on the representation that the IRS had extended the deadline for comments on the PLR request, the Board extended the two deadlines in its May 5, 2006 Order until noon on May 11, 2006.

The Board submitted comments to ACE for submission to the IRS, along with a copy of the Board's May 5, 2006 Order. In its comments, the Board submitted that the IRS should hold ACE's PLR request in abeyance and instead address the issues raised by ACE's request through a rulemaking, which already is in progress. By letter dated May 15, 2006, the Board also informed the IRS that, in view of a change in circumstances as a result of two proposed rulemakings by the IRS and the Board's May 5, 2006 Order directing ACE to withdraw its PLR request, the Board no longer believes ACE's 2002 PLR request is adequate and complete in accordance with IRS procedures.

ACE has not filed a copy of its withdrawal of the PLR with the Board's Secretary, and has not filed a withdrawal and/or a request to hold the PLR request in abeyance with the IRS. On or about May 11, 2006, ACE filed a Notice of Appeal from the Board's May 5, 2006 Order in the Superior Court of New Jersey, Appellate Division. By letter dated May 18, 2006, ACE moved before the Board to reconsider its May 5, 2006 Order or in the alternative to stay the Order pending appeal ("Motion").

In its Motion, ACE argued that while the May 5, 2006 Order requires the PLR request's withdrawal because of the existence of pending IRS regulations, the regulations address only ITC and EDIT and do not address ADFIT. Noting that it has approximately $9 million of ITC, $1 million of EDIT, and $100 million of ADFIT, ACE argued that the IRS rulemaking, therefore, has no relevance to the bulk of the monies at issue in the PLR request, for which ACE claims it requires the IRS' guidance. It maintained that a stay is appropriate in light of the significant and irreparable harm which may be visited upon the Company and its customers, should the PLR request be withdrawn and the IRS commence enforcement actions against the Company. It noted that the stranded cost amounts utilized for recovery by ACE and for securitization purposes, had been reduced by the ADFIT amount, and that in seeking guidance from the IRS, ACE sought to avoid the imposition of penalties for normalization rule violations, which would entail a loss of the ability to utilize accelerated depreciation for all of ACE's public utility property. This loss, it asserted, would, in turn, cause a financial hardship upon the Company, and ultimately result in an adverse impact to customers' rates. It claimed that withdrawal of the PLR request would precipitate an IRS examination and the imposition of penalties, and the fact that a PLR has not been directly issued to ACE would not change the fact that the IRS would be expected to apply the same interpretation of the law which it has set forth in numerous PLR determinations involving similarly-situated utilities. It argued that the Board provided no legal basis for ordering ACE as a taxpayer not to continue to seek the IRS' guidance, and that the only appropriate course of action to avoid financial penalties on either the Company or its customers is to receive the IRS' guidance in the form of the PLR as ACE had requested.

Given the IRS' timing which called for a PLR to be issued by May 25, 2006, in order to address ACE's stay application, the NJBPU met in a special meeting, called on an emergency basis, on May 19, 2006. The NJBPU determined to hear oral argument on the motion by ACE and the RPA on May 22, 2006. ACE's oral argument largely reiterated assertions in its written motion summarized above. The RPA, which had not had adequate time to provide a written response to ACE 's motion, argued orally that ACE's motion should be denied.

The RPA emphasized that it strongly believes that these funds belong to the ratepayers who paid for and are still paying for, through the securitization of stranded costs, the generation formerly owned by ACE prior to restructuring. It asserted that by filing this motion and its appeal, it appears that the Company has forgotten EDECA's mandate that the utilities mitigate stranded costs. It argued that the Board's decision to order ACE to withdraw its PLR request was the correct decision in light of EDECA and to insure a fair outcome. It also asserted that ACE has not pointed to any errors of law or fact that should cause the Board to reconsider its May 5, 2006 decision and merely expanded on points previously made in its April 24, 2006 letter to the Board, including the argument that the pending IRS regulations do not address the proper treatment of the tax benefits associated with the ADFIT.

With respect to the Company's argument that substantial penalties would be incurred if the PLR is withdrawn, the RPA argued that this claim is made without any supporting citation to support its conclusion. The RPA contended that ACE claims that any violation of the IRS normalization rules may have serious consequences but does not attempt to quantify by specific dollar amounts these serious consequences nor does it clarify the adverse impact on ratepayers, and its argument is at best speculation. It questioned why, if the Company was facing such grave consequences, ACE did not appeal the Board Order to offset ADFIT from stranded costs. It further contended that ACE provided no explanation concerning how continuation with the PLR process would prevent the Company from being in a position of having violated the IRS normalization rules, and argued that if the Company is in violation, the PLR is not going to cure that violation. It asserted, however, that if the PLR is issued before the IRS rules on the ITC issue, and there still is a chance that the IRS regulation would be favorable, then that could present a barrier to flowing the ITC back to customers.

It further argued that ratepayers will be harmed if ACE is found not to be following a normalization method of ratemaking, because the rate base deduction from ADFIT will disappear, but it should be clear that ratepayers already have paid for the deferred income taxes. If ACE is required to pay those as current tax expenses, the RPA asserted that it cannot turn to customers to pay that cost because, in fact, customers have already paid it, plus 60% more than that because of the gross-up of deferred income taxes in ratemaking.

The RPA also claimed that the Company's argument fails to acknowledge that there could be a subsequent IRS rulemaking regarding the ADFIT, and suggested that the Company should take the initiative - mindful of its statutory duty to mitigate stranded costs - and specifically petition the IRS for a rulemaking proceeding to address the ADFIT issue.

The RPA further argued that the Company expressed concern that the withdrawal of the PLR request will impose substantial harm on its customers, but that the Company fails to recognize that if a PLR is issued there may be a substantial negative impact on ACE's rates. ACE's motion makes it clear that the Company anticipates an adverse ruling from the IRS, which would apparently put its tax benefits in jeopardy. The RPA argued that prudency required that the utility seek the Board's permission to withdraw the request for a PLR on its own, rather than being required to do so by the Board, and if ACE does not withdraw the request, any adverse consequences resulting from an adverse ruling would be the responsibility of ACE's management and shareholders.

The RPA noted that if the PLR request is withdrawn, ratepayers are given a reprieve. It argued that ratepayers are given a chance to see a positive result from the Board's comments on the December 2005 regulation and recover ADITC and EDFIT amounts and the IRS could come out with a proposed regulation on the treatment of ADFIT, giving the Board an opportunity to review the proposed regulation and comment on it. The Company also could petition the IRS for a rulemaking proceeding to address ADFIT. The RPA stated that it is also possible that penalties could be assessed as the Company claims and the utility may be found to be in violation of IRS normalization rules, but this is speculation. At this point, according to the RPA, what is known is that the withdrawal of the PLR request is the best option available to ACE's ratepayers.

The RPA also argued that the Company's request for a stay is without merit. The RPA argued that the movant has the burden to show that a stay is necessary to prevent irreparable harm, and ACE's motion does not clearly outline how it would be harmed by withdrawing the request for a PLR. The RPA asserted that if the PLR is issued, the Company will request a rate increase for the amount credited to ratepayers in the stranded costs proceeding equal to the

ADFIT. If the PLR request is withdrawn, the Company claims that withdrawal "would precipitate IRS examination and the imposition of penalties for any violation of the normalization rule by the Atlantic Electric," citing Motion, at 7. The RPA argued that either way, ACE would claim that the ratepayers should pay for any tax consequences and not the Company's shareholders, and therefore, ACE cannot show how it will be harmed.

DISCUSSION AND FINDINGS

The Board has carefully considered ACE's motion for a stay of the Board's May 5, 2006 Order and the RPA's opposition thereto. In considering ACE's application, the Board is mindful that a stay pending appeal is an extraordinary equitable remedy which should be granted only when a movant establishes: (1) a likelihood of success on the merits, (2) irreparable injury to the movant absent a stay, (3) no substantial harm to other parties, and (4) no harm to the public interest. United States v. Key Oil Co., Inc., 460 F. Supp. 878 (D.N.J. 1978), citing Pitcher v. Laird, 415 F.2d 743, 744-745 (5th Cir. 1969); Virginia Petroleum Jobbers Assoc. v. Federal Power Commission, 259 F.2d 921 (D.C. Circuit 1958); United States v. Key Oil Company, Inc., 460 F. Supp. 878 (D.N.J. 1978); and See Crowe v. DeGioia, 90 N.J. 126, 132-34 (1982); Parks v. Commerce Bank, N.A., 377 N.J. Super. 378, 387 (App. Div. 2005); Coskey's T.V. & Radio Sales v. Foti, 253 N.J. Super. 626, 639 (App. Div. 1992); Zoning Bd. of Adj. of Sparta Tp. v. Service Electric Cable Television of N.J., Inc., 198 N.J. Super. 370, 379 (App. Div. 1985). A stay is not a matter of right, even if irreparable harm may otherwise result. Yakus v. United States, 321 U.S. 414, 64 S.Ct. 660, 88 L.Ed. 834 (1944). Rather, it is an exercise of sound judicial discretion; the propriety of its issue is dependent upon the entire circumstances of a particular case, and "consideration of justice, equity and morality." Virginia Railway Company v. United States, 272 U.S. 658, 672-73, 47 S.Ct. 222, 228, 71 L.Ed. 463, 471 (1926); Coskey's T.V. & Radio Sales, supra, at 253 N.J. Super. 639 (quoting Zoning Bd. of Adj., supra, 198 N.J. Super. at 379).

Because a stay is the exception rather than the rule, GTE Corp. v. Williams, 731 F.2d 676, 678 (10th Cir. 1984), the party seeking such relief must clearly carry the burden of persuasion as to all of the prerequisites. United States v. Lambert, 695 F.2d 536, 539 (11th Cir. 1983). Further, mere monetary loss alone does not constitute irreparable harm. Morton v. Beyers, 822 F.2d 364, 372 (3d Cir. 1987).

Turning first to whether ACE will suffer irreparable injury absent a stay, the Board finds that ACE has failed to demonstrate that a withdrawal of the PLR request will cause it to suffer irreparable harm. As a threshold matter, the Board notes that ACE's motion does not allege any harm with regard to a withdrawal of the EDFIT and ITC related aspects of its PLR request, nor has it in any way demonstrated how it would be harmed by attempting to have the IRS hold its PLR in abeyance, which it had suggested as an option in its April 24, 2006 letter, and which the Board's May 5, 2006 Order provided for as an alternative to withdrawal.

With regard to ADFIT, ACE asked the IRS to determine that applying ADFIT to reduce the stranded costs associated with its nuclear facilities would not violate the requirements of the normalization rules set forth in the Internal Revenue Code. ACE Motion, at 8. The IRS has advised ACE and the Board that it intends to issue a PLR stating that the Company's past application of ADFIT to reduce stranded costs (as ordered by the Board) violated normalization rules. ACE Motion, at 5. ACE stated that in seeking guidance from the IRS, the Company seeks to avoid having the IRS impose penalties if it determines that the application of ADFIT to reduce stranded costs violates the normalization rules. Ibid. ACE asserted that it will avoid penalties for the violation if it obtains the PLR, and implied that it will be subject to penalties if it withdraws the PLR request. Ibid. For the reasons discussed below, the Board finds no reason to conclude either that the withdrawal of ACE's request for the PLR would increase the likelihood or magnitude of penalties, or that the converse would be true if the PLR were issued. Therefore, the Board finds that ACE has failed to demonstrate that irreparable harm would result from the withdrawal of ACE's request for a PLR.

To support its claim of more lenient treatment from the IRS if the PLR is issued, ACE provided no basis in statute, regulation, case law, or IRS guidance in its motion or in oral argument. When asked for this basis at oral argument, ACE cited no statute, regulation, case law, or IRS guidance. The Company cited only a "practice note" from a treatise on the law of utility taxation, which stated that private letter rulings were commonplace for normalization issues because of the magnitude of the potential remedies for a normalization violation. The Company cited no reason why penalties would be mandatory if the Company withdraws its PLR request, and cited no reason to believe that the IRS would exercise its enforcement discretion to impose penalties simply because the Company complied with the Board's Order and withdrew its request for a PLR to allow for IRS guidance to be provided through rulemaking.

ACE suggested in oral argument that the IRS would view the Company's situation more favorably if the request for the PLR were not withdrawn. ACE offered no support for this suggestion in statute, regulation, case law, or IRS guidance. Accordingly, the Board does not find the suggestion credible, especially because ACE did not seek the IRS' guidance until it was far too late to prevent what the IRS apparently views as a violation.

ACE also claimed in oral argument that the withdrawal of its PLR request would actually create the violation of normalization requirements. Specifically, ACE contended that the requirement to apply ADFIT to offset stranded costs was "provisional" in the Board's 2000 Order, and that it would become "final" once the PLR request was withdrawn. The Board disagrees. The requirement to apply ADFIT to offset stranded costs has not yet been resolved, and will not be resolved if the PLR request is withdrawn, because the IRS will not yet have spoken on the issue. The Board emphasizes that its determination whether ADFIT, EDFIT and ADITC are to be flowed-through or otherwise credited to ratepayers continues to remain open pending the resolution of the issue through IRS rulemaking, and the Board's final determination of the net proceeds and stranded costs also remains open. Thus, while the Board in the May 5, 2006 Order modified the 2000 Order's requirement to obtain a PLR, the withdrawal of the PLR will not render the 2000 Order a final Order on the ADFIT or other tax benefit issues.

Furthermore, even if ACE had reason to believe both (i) that the IRS would assess penalties for the past normalization violation and (ii) that the Company could avoid these penalties if it obtained the PLR, those monetary penalties would not constitute "irreparable harm." Generally, harm which is incapable of being adequately redressed by monetary damages is considered irreparable in equity while monetary loss alone does not constitute irreparable harm. Crowe, supra, at 132-33; Morton v. Beyers, supra, at 372.

In contrast, staying the Board's May 5, 2006 Order would potentially bring substantial harm to ratepayers' interests. Indeed, the Board issued its Order because of its legitimate and significant concerns that issuance of a PLR could substantially harm ratepayers. Prior to divestiture, ratepayers funded ACE's assets through depreciation charges and post-divestiture, ratepayers are paying $675 million over the 20-year life of the transition bonds issued by ACE to recover the stranded cost of its nuclear units, or approximately $34 million annually. Accordingly, the flow-through issues are of substantial and vital concern to ratepayers, who, pursuant to EDECA, are entitled to the mitigation of stranded costs. N.J.S.A. 48:3-50(c)(4);

N.J.S.A. 48:3-61(f); N.J.S.A. 48:3-62(b)(1)

ACE itself has outlined the harm to ratepayers' interests that will result if the Board grants the stay and allows the Company to obtain the PLR. In oral argument, ACE has advised the Board that if it receives the PLR, it intends to seek relief from the Board to correct what the IRS apparently believes to be a normalization violation. That corrective action would increase the amount of the Company's stranded costs by more than $100 million, and transfer this burden to the ratepayers. ACE has also stated that with the PLR in hand, a denial of such relief would subject the ratepayers to even more serious financial consequences, including the disallowance of accelerated depreciation with respect to its regulated generation, transmission, and distribution assets in service at the time of the normalization violation. Motion, at 8.

As to ACE's likelihood of success on the merits of its appeal from the Board's May 5, 2006 Order, none of ACE's arguments demonstrates a likelihood of success on the merits of its appeal. As a threshold matter, the Board has carefully considered ACE's contention that there is no legal basis for the Board to order ACE, as a taxpayer, not to seek guidance from the IRS. Motion, at 6, 10. ACE provided no support for its implicit claim that the Board cannot order the withdrawal of the PLR so that issues can be pursued and guidance obtained through rulemaking. The Board recognizes that ACE is a taxpayer, and that the questions it has posed to the IRS are legitimate ones. However, ACE differs from a typical taxpayer seeking a typical PLR. ACE is a public utility, which is subject to regulatory authorities inapplicable to non-utility taxpayers. The Board has been granted "general supervision and regulation of and jurisdiction and control over all public utilities . . . and their property, property rights, equipment, facilities, and franchises so far as may be necessary" for the purpose of carrying out its statutory responsibilities. N.J.S.A. 48:2-13. The Board's statutory responsibilities include ensuring just and reasonable rates. N.J.S.A. 48:2-21; In re N.J. Am. Water Co., 169 N.J. 181, 187 (2001). Indeed, "foremost among the Board's responsibilities is its obligation and duty to ensure that rates paid by consumers are not excessive." In re Revision of Rates by Redi-Flo Corp., 76 N.J. 21, 39 (1978). The resolution of ACE's legitimate questions for the IRS is one that can affect the rates that its customers pay. If the question is resolved so that ACE can flow its deferred tax benefits through to ratepayers without putting the Company in violation of applicable tax law, then the resolution of the question will help to reduce rates. If the question is resolved in a way that prohibits flow-through, then the resolution will not help to reduce rates. As noted above, ratepayers funded ACE's assets through depreciation charges prior to divestiture, and post-divestiture, ratepayers continue to fund stranded costs related to those generating assets. Furthermore, as the RPA noted, EDECA requires the mitigation of stranded costs. N.J.S.A. 48:3-50(c)(4); N.J.S.A. 48:3-61(f); N.J.S.A. 48:3-62(b)(1). Thus, the Board and the ratepayers have an especially strong interest in the disposition of tax benefits related to those same generating assets

Additionally, the legitimate questions that ACE seeks to have the IRS answer are of very strong interest to the Board and to the RPA as well. A PLR is a written statement that the IRS issues to a particular taxpayer, to interpret and apply tax laws to that particular taxpayer's specific set of facts. For that reason, in a typical PLR, third parties beyond the taxpayer and the IRS do not normally hold such strong interests in the outcome. Accordingly, the Board has considered the position of ACE as a taxpayer with legitimate questions for the IRS, and concluded that this public utility taxpayer should not seek an answer to its question, a question also for the Board and the RPA, in a way that would conflict with the Board's obligation to ensure just and reasonable rates.

ACE also asserted that there is no basis to support the Board's Order directing ACE to withdraw its request for the PLR (or to have the request held in abeyance), because the Board's "stated rationale, the pendency of IRS regulations, has no relevance to the bulk of the monies at issue in the PLR request." Motion, at 6. This assertion misstates the Board's rationale. ACE correctly states that the IRS' recent rulemaking proposals would address ADITC and EDFIT, but not ADFIT, although the Board notes that the notice of proposed rulemaking's background section does discuss ADFIT. In any event, that distinction makes no difference in the Board's reasoning. The Board sought to have ACE withdraw the request (or have it held in abeyance) because a private letter ruling would be an improper means of resolving the flow-through issues. As the Board pointed out in its Order, the IRS asserted that neither the Board, the RPA, nor any other third party would have standing to contest a private letter ruling through judicial review. May 5, 2006 Order, at 6. "The IRS should not take action of such broad scope and applicability, with such a large financial impact on millions of ratepayers, through a piecemeal process that eliminates any real scrutiny on behalf of the many people affected by the action." Ibid.

The flow-through issues for all three tax balances arise from similar circumstances, which are common to electric utilities in states that have undergone restructuring and in which utilities divested themselves of their generating assets. The failure of the IRS to address ADFIT in its proposed regulations does not make the need for rulemaking to address all three issues any less acute. The federal Administrative Procedure Act, 5 U.S.C. §500 et seq., requires an agency to undertake rulemaking to "separately state and currently publish in the Federal Register for the guidance of the public . . . substantive rules of general applicability adopted as authorized by law, and statements of general policy or interpretations of general applicability formulated and adopted by the agency." 5 U.S.C. §552(a)(1)(D). The action that the IRS is taking in numerous PLRs involving similarly-situated utilities is of such general applicability. The federal courts have rejected past agency efforts to adopt agency policy positions with legal consequences without subjecting those efforts to the public notice, public comment, and judicial review associated with rulemaking. See, e.g., Appalachian Power Co. v. EPA, 208 F.3d 1015 (D.C. Cir. 2000):

> The phenomenon we see in this case is familiar. Congress passes a broadly worded statute. The agency follows with regulations containing broad language, open-ended phrases, ambiguous standards and the like. Then as years pass, the agency issues circulars or guidance or memoranda, explaining, interpreting, defining and often expanding the commands in the regulations. One guidance document may yield another and then another and so on. Several words in a regulation may spawn hundreds of pages of text as the agency offers more and more detail regarding what its regulations demand of regulated entities. Law is made, without notice and comment, without public participation, and without publication in the Federal Register or the Code of Federal Regulations. With the advent of the Internet, the agency does not need these official publications to ensure widespread circulation; it can inform those affected simply by posting its new guidance or memoranda or policy statement on its web site. An agency operating in this way gains a large advantage. "It can issue or amend its real rules, i.e., its interpretative rules and policy statements, quickly and inexpensively without following any statutorily prescribed procedures." Richard J. Pierce, Jr., Seven Ways to Deossify Agency Rulemaking, 47 Admin. L. Rev. 59, 85 (1995). [FN9] The agency may also think there is another advantage -- immunizing its lawmaking from judicial review.
>
> [208 F.3d at 1020 (emphasis added).

In directing ACE to withdraw its PLR request (or to have it held in abeyance), the Board is not seeking to deprive ACE of guidance from the IRS. The Board is simply attempting to have ACE obtain that guidance in the manner required by the Administrative Procedure Act. The need for rulemaking is not limited to only those subjects that the IRS has already proposed in pending rulemakings. The Board, therefore, finds that ACE is not likely to succeed on the merits of its appeal from the May 5, 2006 Order.

For the foregoing reasons, the Board HEREBY DENIES ACE's motion for a stay of the Board's May 5, 2006 Order. The Board HEREBY DIRECTS ACE to deliver to the IRS, by noon on May 24, 2006, a withdrawal of its request for a PLR. However, ACE may state in its withdrawal that if the IRS agrees not to issue a PLR until after there has been a final resolution of an IRS rulemaking that addresses the tax implications of flowing through the tax benefits to ratepayers, including any appeals from the rulemaking, then ACE's request for a PLR shall be deemed not to be withdrawn. ACE shall simultaneously file with the Board's Secretary a copy of its withdrawal of the PLR, stating the date and time on which the withdrawal was delivered to the IRS. If by noon on May 24, 2006, ACE does not withdraw the PLR request or file for a stay of the Board's May 5, 2006 Order, the Attorney General's Office shall take such action to enforce the Order as may be necessary.

DATED: 5/23/06

BOARD OF PUBLIC UTILITIES
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PRESIDENT

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FREDERICK F. BUTLER
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